# DOW THEORY LETTERS INC.

RICHARD RUSSELL
P.O. Box 15196
San Diego, California

40 Letters per Year — $50.00 Annually

Registered with the Securities Exchange Commission


April 19, 1967 Letter 355

THE MARKET: I have started this Letter off with what I consider a most significant clip from the April 17 issue of U.S. News & World Report.

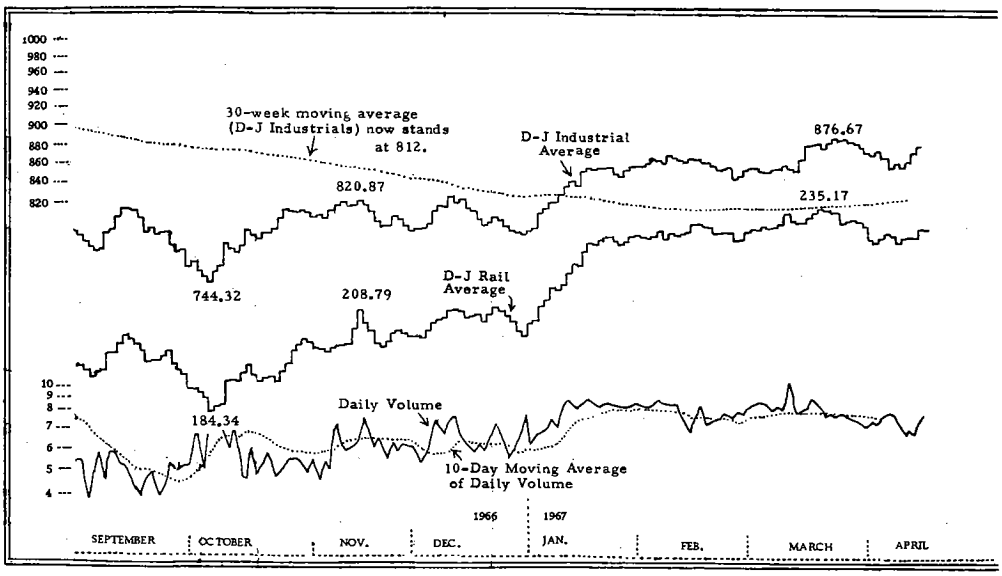
> People at the moment are one of Mr. Johnson's big worries. The people, it seems, have grown cautious, less inclined to borrow and spend, more in a mood to pay off old debts and maybe get a little money ahead.
>
> Result: A defused boom, shelves piled high with goods, reduced buying, a sharp letdown in private business. People weren't supposed to act that way.

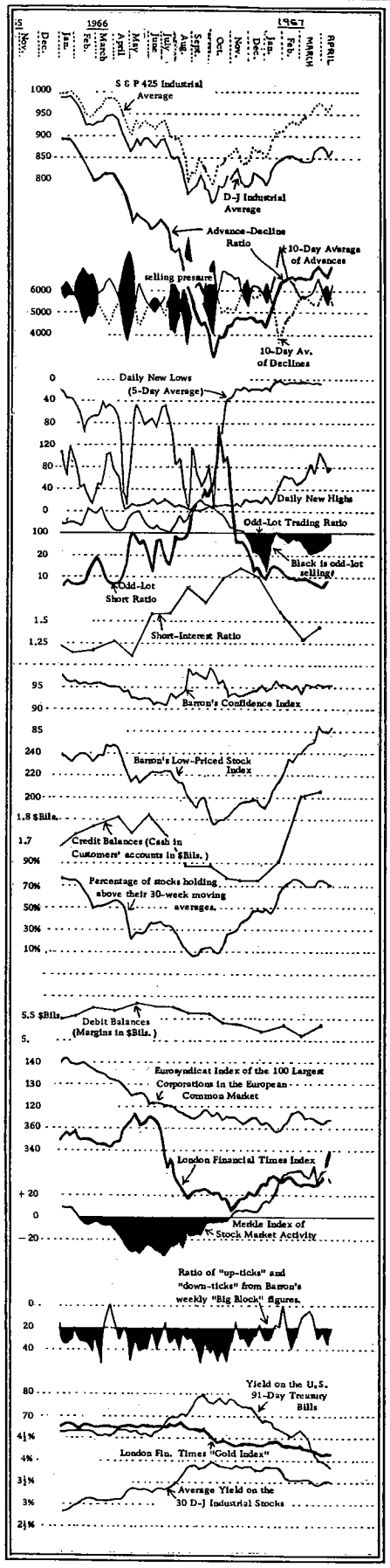
Note that last sentence...."People weren't supposed to act that way." It may come as a surprise to the editors of U.S. News and to the economists of the Great Society, but all history suggests that people are supposed to act that way — during a primary bear market.

Mr. Johnson does not like all these Americans saving instead of spending, so he has put the pressure on to change the "economic climate." The floodgates of money have been opened, interest rates have been driven down, previously "locked-up" funds have been released, the American public has been told with almost hysterical frequency that everything is all right and that a new boom will start in the second half of 1967.

But in my opinion, the U.S. public has grown skeptical of Government pronouncements. The same "credibility gap" which has characterized the Vietnam War news releases now seems to permeate all walks of Government activity. As a subscriber said to me last week, "Why don't they drop this polite 'credibility gap' phrase and call a spade a spade. When we say credibility gap we mean lieing. The very phrase credibility gap is Great Society mumbo-jumbo. We're simply not being told the truth, and the nation is well on its way to realizing this."

I have noticed that the common denomonator of almost all letters received here over the past few months is anger or exasperation at Government "public relations." American consumers, taken in total, can be fooled for a time, but they are not children and they are not idiots. They have seen an undeclared war expand from 25 thousand men in Vietnam in 1964 to over 450 thousand today — all against a background of Government "soothing syrup." Now they see sky-high inventories, gluts of cars and appliances, a housing depression and factory shutdowns, and all against a backdrop of more soothing syrup. Frankly, the





S & P 425 Industrial Average
D-J Industrial Average
Advance-Decline Ratio
10-Day Average of Advances
selling pressure
10-Day Av. of Declines
Daily New Lows (5-Day Average)
Daily New Highs
Odd-Lot Trading Ratio
Black is odd-lot selling
Odd-Lot Short Ratio
Short-Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Credit Balances (Cash in Customers' accounts in $Bils.)
Percentage of stocks holding above their 30-week moving averages.
Debit Balances (Margins in $Bils.)
Eurosyndicat Index of the 100 Largest Corporations in the European Common Market
London Financial Times Index
Merkle Index of Stock Market Activity
Ratio of "up-ticks" and "down-ticks" from Barron's weekly "Big Block" figures.
Yield on the U.S. 91-Day Treasury Bills
London Fin. Times "Gold Index"
Average Yield on the 30 D-J Industrial Stocks

American public is fed up with official pronouncements, and I believe that next stage is going to be anger. To quote a Government official in the same issue of U.S. News, "If consumers don't start spending soon, we will be headed for trouble." For my part, I am highly dubious regarding the Government's efforts to "jazz-up" the consumer again. When people are suspicious and bothered, they tend to pay off debt and build up some sort of financial cushion via the savings bank.

We might remember that the discount rate was lowered 9 times between 1929 and 1932, and all that easing up on the price of money never inspired Americans to go out and spend their heads off. Any psychiatrist knows that you cannot talk a patient into being confident. He learns confidence by facing the real truth about himself, regardless of how painful that truth may be. The Great Society might learn a lesson from the psychiatrists.

Many observers were surprised when the market sold off following the reduction of the discount rate from 4.5% to 4.0%. But others took the lowering of the discount rate to be (1) simply the Fed's effort to get the bank rate in line with Treasury bill yields, (2) the last act in the money managers' bag of tricks to get the economy going again, (3) an official admission that the country is in much greater trouble than has been officially admitted. At any rate, everyone knew that with Treasury bill yields under 4%, it was just a matter of time before the discount rate was lowered. Many traders were waiting to unload under the guise of "good news" on the discount rate. And that, simply stated, is what occurred.

GOLD: When the Neo-Keynesians and the Great Society promulgators run into trouble, they frequently adopt the following procedure (1) put out a few news "feelers" and see which one seems to arouse any sort of a following, (2) allow some source such as a bank or a business spokesman to express a new gimmick. If that gimmick doesn't raise too much of a "stink" around the country, try it.

Stentorian voices have been warning of a possible crisis this year. Robert Triffin of Yale said that trouble could come in a matter of months, and Robert Roosa, earlier this year, saw fit to warn that unless we moved faster on the payments deficit, trouble was on the way. Finally, our own Secretary of the Treasury Fowler has gone into a quiet panic.

How to act? Well, first Fowler has tried to get agreements from our creditors to the effect that they will not take any more of the gold which they are entitled to take (for dollars which they hold). That was the "nice" request. Next, two leading banks, Bank of America and Chase Manhattan, opined (and of course this was not an Administrations statement) that if foreigners continue to turn dollars in for gold, the U.S. will have to terminate its gold selling policy. A few other Neo-Keynesians advanced the rather shop-warn theory that it was the dollar which was holding up the price of gold at $35 per ounce rather than gold setting the price for the dollar. If this is true, then nobody has explained why the U.S. would want to keep any gold at all, rather than threatening to shut off gold sales in case of too many buyers.

At any rate, the next step was to deny that the U.S. itself is in trouble. Last Friday Bank of America President Peterson stated that "We should make it abundantly clear that we intend not to permit our balance-of-payment policies to damage the world economy." This is tantamount to a man who is bankrupt saying that he will not close out his merchandise because he does not want to hurt the market for his competitors.

What's really happening? In the last 9 years the U.S. has spent or given away $24 billion more than it has taken in. This has piled up dollars outside the U.S., dollars which can be turned in to the U.S. for gold. During the last 9 years, over $9 billion of these dollars have been turned in. Actually, foreign banks now hold $12.7 billion with another $13.7 billion in private hands that could be turned in to Central Banks. To cover this, the U.S. has only $13.2 billion in gold—and $10 billion of this is earmarked to back the currency. In all, hardly a pleasant situation.

So finally, the U.S. has developed that idea of the twin threat. (1) If you keep calling in our gold we are going to stop selling it. (2) If you keep buying our gold you are going to hurt yourself via an international monetary crisis. This point was developed by Chase Manhattan Vice-President Deaver in a story in the Wall Street Journal: "Mr. Deaver emphasises that Chase is not advising the Government to stop selling gold now but only to 'tell the other countries right now what the consequences will be. ...if they keep draining our gold.'"

Perhaps back of the entire new barrage of cajolings and warnings is a U.S. attempt to "get off the hook" by pressuring its creditors into what is politely termed "monetary reform." Monetary reform is anything which will create more paper reserves while taking the pressure of fiscal restraint off U.S. politicians and U.S. inflationists. For the whole thing boils down to political votes, and votes in the Great Society come via spending and handouts. In order to spend you have to have money, and if you can't get enough money via taxes and borrowing, then you have to print it. If you print it you are going to have gold problems, and gold problems tend to make men honest. Politician's dream, therefore, is to get rid of gold.

* * * *

Apropos of the comments in the last Letter, it has just been announced that China and Russia have now agreed on routes and deliveries of war material for Vietnam. I expect this to expand the pace of the war and to push up casualties.

Incidentally, I recommend author Mary McCarthy's new series on Vietnam now appearing in the New York Review of Books. This McCarthy paragraph neatly captures the flavor of war during the boom: "Of course, all wars have had their profiteers, but it has not usually been so manifest, so inescapable. The absence of the austerity that normally accompanies war, of civilian sacrifices, rationing, shortages, blackouts (compare wartime London or even New York, twenty-five years ago) makes this war seem singularly immoral and unheroic to those who are likely to die in it—for what? So that Saigonese and other civilians can live high off the hog? The fact that the soldier or officer is living pretty high off the hog himself does not reconcile him to the glut of Saigon; rather the contrary. Further-more, an atmosphere of sacrifice is heady; that-and danger-is what used to make wartime capitals gay. Saigon is not gay. The peculiar thing is that with all those young soldiers wandering about, those young journalists news-chasing, Saigon seems so middle-aged-inert, listless, bored. That, I suppose, is because everybody's principal interest there is money, the only currency that is circulating, like the stale air moved by ceiling-fans and air-conditioners in motels and offices."

Again we should remember that lowering the discount rate during a bear market is a vastly different thing than lowering the discount rate during a recession in a primary bull market such as during 1958 or 1960. "Dow's Theory pays no attention whatever to wishful thinking of industrial leaders as expressed in bullish pronouncements," wrote Robert Rhea in 1937, "it makes little of Presidential scoldings. The primary trend of business and stock prices cannot be 'talked up' or 'forced down' by the President, by Congress or by any single man or group of men."

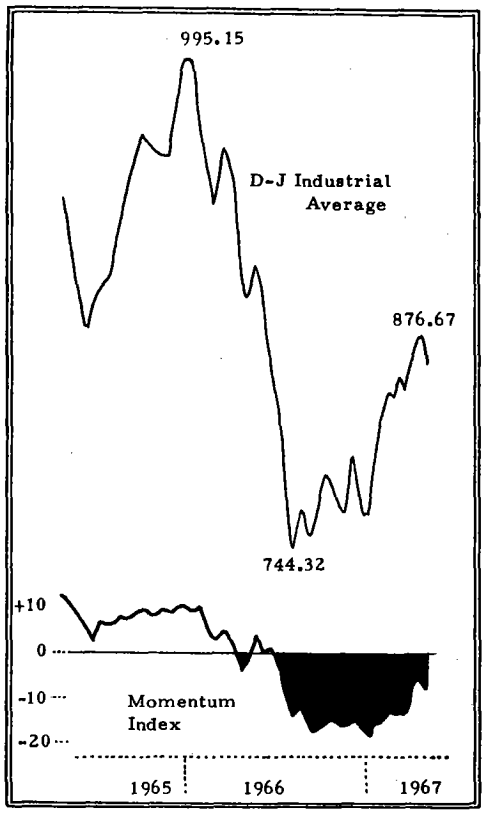
On April 10 the D-J Rails broke to 225.77, thereby penetrating their February low and sinking to their lowest level since January. Industrials, however, failed to penetrate their comparable February low of 836.64. From the recent April lows, the Averages backed-and-filled as volume dropped to its lowest level since December. Then, late last week the market came alive, and a new rally was mounted. Volume expanded as the Averages worked up toward the March highs again. But it is noteworthy that for the first time since the October lows, Rails have been the laggers on the rally. Volume, too, has dropped to lower levels than were seen at the March recovery peak.

The market over the past few months has provided us with two sets of benchmarks, the 876.67 and 235.17 recovery highs of March and the February Industrial low of 836.64 and April Rail low of 225.77. Joint penetration of the highs would imply further gains and perhaps a try for the 900 area, while joint penetration of the lows would suggest that the primary bear forces are coming into play again. Actually, it would be most unusual for a secondary (upward) correction as powerful as this one to have expired suddenly—with no outward signs of weakness and no series of warnings. For this reason, it would not surprise me to see at least one Average try for the recent March highs again.

However, as outlined in page 4 of the last Letter, I believe that the peak of strength has passed for this move. My guess is that any further rally from here will be accompanied by signs of technical weakness with perhaps one or both Averages failing to confirm on the upside.

Because this is a bear market many of my subscribers expect the market to be continually in the throes of violent downside action. It simply does not work that way. Following the 1929 crash which touched lows in November, the market mounted a great rally into April, 1930. Although the Averages peaked in April, it was not until November of 1930 that the Dow components broke into new low ground (below the 1929 lows). The current bear market is being fed more "fuel" and is subject to more Governmental manipulation than anything the citizens of 1929 ever dreamed of. Therefore, it could conceivably take more time than during 1930 before new lows are seen. Patience is going to be a scarce commodity during the next few years, and lack of patience is going to cost many people their life-savings before this bear market has breathed its last.

But for those of us who have the maturity and perseverance to wait for the ultimate bottom, I believe that the rewards will be great. Only once or twice in a lifetime can a man buy high-grade blue-chip and growth stocks at greatly depressed prices. I believe such a period is coming up—for those who have the money to take advantage of it.




MOMENTUM: Letter 325 discussed the concept of momentum in detail. If a ball is tossed into the air, at a certain point it will falter, then come to an actual dead stop, finally return to earth at an increasing rate of speed. This same principle of increasing upward momentum, loss of momentum, halt, then increasing rate of downward momentum may be applied to the motion of a stock or a stock average.

Analysts make use of many types of "momentum indices," but to me the most useful are those which measure momemtum over a long-term period such as one year. For a number of years I have kept one-year momentum indices of the Dow Industrials and the 10 leading stock averages of the free world. A study of these 11 indices provides an excellent "picture" of what is occurring in world markets. Along with 11 momentum indices I also plot momentum charts of the London Economist's Basic Commodity Indices. Thus, a study of the 15 momentum index charts gives me a sort of "universal primary trend" profile of what is occurring throughout the markets of the Free World.

I would like to show subscribers what all 15 of these momentum indices are doing, but space forbids it. I have, however, included a chart of the Dow Industrials since 1965 along with the momemtum index of the Dow. This latter is simply the ratio of the Dow today compared with its price exactly one year ago. In other words, the lower index on the chart shows the percentage of increase or decrease of the Dow today compared to its price a year ago.

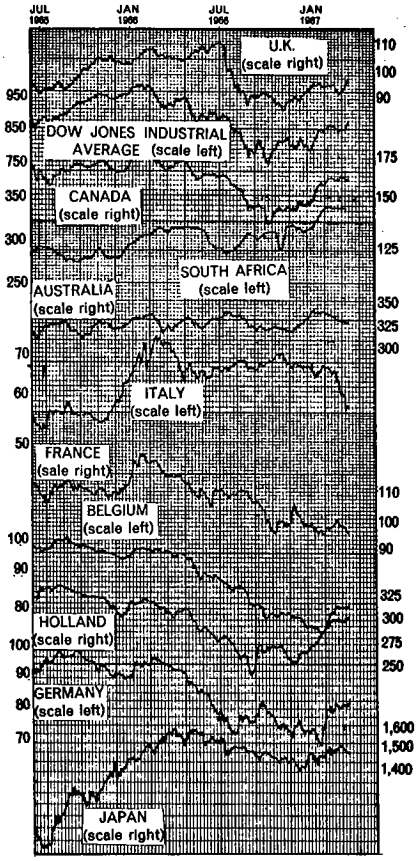
Note that the Momemtum Index broke below zero around mid-1966, and that the momentum index (MI) has held below zero ever since. During primary bear markets it is normal for the MI to break below zero and stay there for most of the life of the bear market. This is just another way of saying that during primary bear markets the Dow tends to stay below its price of one year ago. Major corrections often succeed in taking the MI back to zero (or slightly above), but then the onset of the bear forces drives the MI down into deep minus territory again.

Primary trends tend to be worldwide in scope. Therefore, I consider it no coincidence that 10 out of the 11 world MI's which I chart are now holding below zero. Here are the latest figures: London minus 3.6%, N.Y.S.E. minus 8.9%; France minus 21%; Germany minus 11%; Holland minus .5%; Italy minus 15%; Canada minus 2.3%; Belgium minus 17%; Australia plus 2.3%; Sweden minus 10%; Japan minus 8%. Of the world commodity price MI's, All Items is minus 11%. All Items is made up of Food which is minus 1.9%; Fibers minus 5.6%; Metals minus 43%.

Thus, of the fifteen MI's only one, Australia, is in the plus column. This says alot about the world situation (which I firmly believe is in the early stages of a primary bear market). If you want to be optimistic perhaps the moral is to look towards Australia. Certainly there is much to be said for the one out of fifteen indices which is above its price of a year ago.

There is one other foreign index which (although I do not chart its MI) is above its year-ago price. This is the industrial average of South Africa. There a great boom is under way, and so intent is the S. African government upon containing the boom that they have recently imposed a new 5% corporate tax on S. African corporations. This has affected gold mines particularly, since the latter cannot raise their selling price.

I have included a ratio scale chart of 11 leading stock averages for study. Note the great and deceptive upward correction in the Italian index. To all purposes, this looked like a new bull market in Italy— until their market suddenly reversed and plunged below the 1966 lows (only a few weeks ago). Chart courtesy of Security Analysts Ltd., 354 Kensington Rd., London S.E. 11, England.




## PLAN TO END GOLD BACKING UNDER STUDY

WASHINGTON (DJ) —Government officials are considering asking Congress within a few months to end the legal requirement that Federal Reserve currency outstanding be backed to the extent of 25% by gold.

Such a move would free more of the nation's dwindling gold stock for sale to foreign government in exchange for surplus dollars. Lately the 25% "cover" requirement and the increase in the money supply have brought the amount of gold readily available for international use down to around $2.8 billion of the $13.1 billion total.

The rate at which the money supply is being increased for domestic purposes and continuing for domestic purposes and continuing foreign claims would exhaust the free supply of gold in several years and some key strategists would rather move before the action takes on a crisis atmosphere.

WHAT'S COMING UP? The accompanying news clip relates a story that hangs over all the world's markets. Everywhere, nations are attempting to "reflate" or boost up their economies. West Germany has just lowered its discount rate to 3½% from 4%, while there is talk of Britain reducing its discount rate to the 6% level. European business is in recession, and efforts are being mounted to stave off the crisis which seems to be looming over the horizon.

The banking fraternity has now literally repudiated the "feelers" on gold embargo suggested by Chase-Manhattan and Bank of America. "Don't tamper with U.S. credit and the dollar" seems to be their attitude. Nations and individuals, sensing something in the wind, are piling up their hoard of (U.S.) gold, and anything which indicates a weakening of the U.S. gold position only increases their desire to get out of dollars and into gold at the 1933 bargain price of $35 per ounce.

Meanwhile, from all quarters I hear and read that creditor nations are taking an increasingly palsied view of the U.S. monetary situation. With our balance-of-payments deteriorating and the expenses of Vietnam rising, the probability of a run on our gold increases weekly.

And as for Vietnam, I feel it is going to get bigger and vastly more costly. General Westmoreland has asked for 600,00 men in Vietnam, and just this morning it was announced the Party Boss Breznev of Russia has called for a united effort by China and Russia to defeat the U.S. in Russia. I have stated before that I believed that the Communists are fighting an economic war against the U.S. With U.S. war expenses of $85 million per day, who can doubt it?

IN MEMORY: I have been shocked to learn that my old "pen pal" A. Hamilton Bolton died last week in Canada. This is a momentous loss for the investment fraternity. Bolton was a towering figure in market analysis and a pioneer in the field of bank credit analysis. Bolton possessed a rare mind, at once at home with hard facts and with theory. His work in bank credit and in the interpretation of Elliot's Wave Theory form a classic pillar in the history of stock market literature. Ham, I don't wear a hat here in California, but symbolically, I take my hat off to you. Rest in peace.